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Backgrounder

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Financial Sanctions: A Better Way to Target Rogue Regimes

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Over the past decade, economic sanctions programs such as trade embargoes have emerged as the preferred option of the international community and of those countries, particularly the United States, that have been willing to act unilaterally against rogue political regimes regarded as operating beyond the bounds of acceptable behavior. Increasingly, however, economic sanctions have come under fire for the devastating impact they often have on the general population of the target country. In November 2000, for example, Iraq claimed that more than 9,000 people had died during the previous month from diseases — including diarrhea, pneumonia, and other malnutrition-related illnesses — spreading as a result of United Nations' sanctions, compared with 272 deaths in October 1989 just prior to the imposition of the sanctions ("Iraq says 9,000 died last month due to UN sanctions," *Jakarta Post*, November 17, 2000, p. 14).[1]

Such impacts are particularly regrettable since the populations of nondemocratic countries that are typically the targets of sanctions have little opportunity to influence the leadership or policies of their governments. Richard Roth, principal deputy assistant to the US secretary of state, admitted as much when he told a recent Middle East conference that "[i]f you see sanctions as a way to change the [Iraqi] regime then they have not been successful." Former US assistant secretary of state Robert Pelletreau told the same conference that Iraq's suffering under sanctions was accelerating its reintegration among Arab states that see its suffering as excessive and unfair.

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1 In a September 1999 report, UNICEF claimed that children under five in heavily populated parts of Iraq were dying at twice the rate they were ten years ago (United Nations Children's Fund 1999, 27).

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Some commentators regard the sympathy derived from Iraq's plight as emboldening that country "in its efforts to break a decade-old strangle-hold of UN economic sanctions" (Taylor 2000, 5). And former UN secretary-general Bhoutros Bhoutros-Ghali also questioned "whether suffering inflicted in vulnerable groups in a target country is a legitimate means of exerting pressure on political leaders" (quoted in Cortright [1995, 13]). The political masters of target countries are, in fact, often able to profit from the sanctions placed on their countries (see Hufbauer, Schott, and Elliott 1990; Stranks 1994).

Some supporters of sanctions (see, for example, Hufbauer, Schott, and Elliott 1990; Porteous 2000), acknowledging these failings but unwilling to forgo the use of an alternative to indifference and, in some cases, the final option prior to military action, have suggested the imposition of "financial" sanctions as a less blunt and more targeted form of pressure. This type of sanction would be directed not at the general population of an offending country but at its leadership. As Gary Hufbauer argues,

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> [w]hen dealing with authoritarian regimes, the [US] president should direct sanctions at rulers, not the populace at large. Iraqis are not our enemies. Nor are the Cubans. We can single out individuals and agencies that give offense or outrage. We can devise civil and criminal penalties, buttressed by bounties, so that their persons and property are at risk whenever they venture outside their own territory. (1998, C-1.)[2]

While there exist numerous reviews and assessments of sanctions regimes imposed over the past decade (see, for example, Cortright and Lopez 2000; Hufbauer, Schott, and Elliott 1998), little beyond some preparatory work at the UN-sponsored Interlaken Conference in 1998[3] and a recent report by the UN's International Peace Academy (Berdal and Malone 2000) has been done to date to examine what a serious approach to financial sanctions would entail. On the cusp of the new millennium, Canada can play a key role in rehabilitating the reputation of sanctions as a useful foreign policy tool by encouraging multilateral institutions to consider the potential of seriously implemented targeted financial sanctions. As a step in this process, this *Backgrounder* examines the practicality of financial sanctions targeted at offending authoritarian leadership, and how they might best be employed. Note that I focus here on multilateral sanctions, not unilateral sanctions of the type imposed by, for example, the United States against Cuba. I also leave aside the interesting issue of the imposition of sanctions by bodies such as the International Labour Organization (ILO) whose membership includes

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2 Another commentator notes that "[t]here appears to be a growing consensus within the UN that sanctions should be more narrowly focused at specific leaders responsible for the situation that has caused the Security Council to take action. The freezing of assets and other financial sanctions fit this category" (Stremlau 1996).

3 See Switzerland (1998). The conference concluded that financial sanctions would require clearer identification of targets and the ability to identify and control financial flows. Participants expressed particular concern over the need to help UN member states improve their domestic implementation, both legally and administratively, of financial sanctions.

nongovernmental organizations and whose power is limited to encouraging members to act in a particular fashion.[4]

The Need for a New Sanctions Tool

Critics of sanctions point out that, over the past decade, a plethora of carelessly conceived and erratically enforced programs has, not surprisingly, produced disappointing or, at best, mixed results. Indeed, Canada's and the international community's recent experience with Iraq, Yugoslavia, and Sudan has shown that general trade sanctions or more specific ones targeting diplomatic ties or travel, however well-intentioned, are almost always unsuccessful when applied to authoritarian regimes. Yet, while I recognize the validity of these assessments, I argue that the use of these earlier, often sloppy and half-hearted sanctions efforts says nothing about the potential of some of the newer, more refined sanctions tools now under consideration.

In the wake of the generally recognized failure of comprehensive sanctions such as those imposed on Iraq, the United Nations, through what has become known as the "Interlaken Process," has begun to examine seriously the potential of the promising new tool of targeted financial sanctions. It is an option that lies between the casual, ultimately ineffectual cruelty of general trade sanctions and the all-too-obvious drawbacks of military intervention.

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Targeted financial sanctions operate on the unfortunate but realistic principle that the leadership of authoritarian regimes and their associates tend to respond more quickly to direct threats to their personal financial health than to any ongoing assault on the general well-being of the people they govern. For the price of a few cruise missiles, targeted financial sanctions can hit the offending leaders of errant states and their associates with the precision and impact of a smart bomb, decimating their bank accounts and their business relationships and unleashing pressures on targeted regimes that general trade sanctions could never hope to duplicate.

The primary goal of targeted financial sanctions is to change the offending policy of the targeted authoritarian leadership. Importantly, financial sanctions target those making the decisions in the rogue state, not the country's population at large. An approach using targeted financial sanctions recognizes the importance of economic agendas in shaping the nature and direction of civil strife, and presumes the targeted leaders and their associates will be influenced by financial pressure. Such an approach also recognizes the injustice and uselessness of aiming sanctions at a population that is unable to influence the decisions of its leaders.

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4 In November 2000, the ILO was poised to recommend that its member governments, workers, and employers "review their links with Myanmar [Burma] and take ap pro pri ate meas ures to en sure [that it] can not take ad van tage of such re la tions to per petu ate or ex t end the sys tem of forced or com pul sory la bor" ("ILO sanc tions plan on My an mar seen as gain ing sup port," *Jakarta Post*, No vem ber 17, 2000, p. 13).

Financial Sanctions: Targeting the Leadership Group

Iraq's 1990 invasion of Kuwait led to the most elaborate sanctions program ever established by the United Nations — including the prohibition of all trade and financial transactions with Iraq and Kuwait, the freezing of the two countries' overseas assets, and the establishment of a sanctions monitoring committee. Yet the personal wealth of the Iraqi leadership remained untouched (Switzerland 1998). Truly effective financial sanctions require targeting the personal commercial and financial well-being of the leadership of offending states. Furthermore, the targeted group needs to be broad enough to encompass not only the state's leaders but also those whose support is essential if the leaders are to maintain their hold on power.

Targeted financial sanctions can take the form of freezing the foreign assets of specifically designated individuals, companies, or governments, or establishing "refusal to deal" regimes that are designed to prohibit financial or commercial dealings (including investment activity) with designated entities. Asset freezing (or asset blocking — the terms are interchangeable) means that, although title to property, be it a boat or a bank account, remains with the targeted country, individual, or entity, the exercise of powers and privileges normally associated with ownership is prohibited without authorization from the appropriate authority.

The United Nations has attempted to use targeted financial sanctions only rarely, and only twice has it gone after a specific faction within a country. In the 1970s, it targeted Cambodia's Khmer Rouge, and in 1993 it imposed sanctions on the National Union for the Total Independence of Angola (UNITA). In May 1994, the UN Security Council recommended freezing the funds and assets of Haitian leaders and their associates. Unfortunately, this action had no legal force in UN member states, and little was accomplished (Cortright and Lopez 2000, 241). In fact, the existing UN sanctions system lacks the institutional capacity to target the financial assets of individual leaders and their associates.

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The same cannot be said, however, of the United States, which has been vigorous in its imposition of monitored, enforced, unilateral financial sanctions against individuals and organizations. For example, it imposed its own sanctions regime against the ruling junta in Haiti when the UN attempt failed. In March 1996, the United States unsuccessfully urged other industrialized countries to join it in freezing the assets of Nigeria's leaders (Stremlau 1996, 10–14). And in 1997, it imposed sanctions on five Chinese individuals, two Chinese companies, and one Hong Kong company out of concern that their activities involved the proliferation of chemical and biological weapons (Burns 1997). Other US targets include "specially designated narcotics traffickers" (SDNTs), a 14-page list of individuals and organizations involved in the drug trade, compiled by the Office of Foreign Assets Control (OFAC), which has imposed millions of dollars in fines on financial institutions for failing to block illicit transfers of funds involving such listed parties (see United States 1999). The United States also targets individuals and organizations engaged in or supporting terrorism. OFAC's

master list of "specially designated nationals and blocked persons" contains the names of more than 5,000 such individuals, government entities, and companies around the world (ibid.).

If the United States can direct this sort of elaborate monitoring and enforcement structure toward individual drug traffickers, terrorists, and their supporters, it seems appropriate that potentially much more dangerous political leaders should have to face a multilateral UN sanctions system modeled in part on the US approach. Unilateral sanctions programs have achieved limited successes, but only a multilateral approach that enjoys the cooperation of the international community will ensure that target states and individuals find no financial or commercial havens in which to do business.

The Goals of Targeted Financial Sanctions

The primary and ideal goal of financial sanctions is to force a change in the offending policy of the targeted authoritarian leadership. Cortright and Lopez note that sanctions can be viewed as successful "if they [have] a positive, enduring impact on bargaining dynamics or if they [help] isolate or weaken the power of an abusive regime" (2000, 204).

The use of targeted financial sanctions should recognize the importance of economic agendas in shaping the nature and direction of civil strife (see Berdal and Keen 1997), and should presume that the targeted leadership would be influenced by financial pressure. This approach is, however, unlikely to work when dealing with true ideologues; in such situations, it would be especially important to ensure that the sanctions are broad enough to encompass those whose support is necessary to prop up the leadership group even if they may not share their leaders' fervor for the cause. Once these supporters realize that the costs of aiding the regime are greater than the benefits, their support can unravel quickly, as seems to have been demonstrated by events played out in Yugoslavia. In early May 1999, reports indicated that Dragomir Karic, a member of Slobodan Milosevic's inner circle and, with his brothers, the owner of the largest private sector business empire in Yugoslavia, had been "secretly negotiating with Russians and Americans in Vienna to allow foreign ground troops to enter Kosovo."[5] Karic, in addition to being a key Milosevic advisor, also represented a Yugoslav business community that clearly wanted an end to the conflict. The sanctions that were directed toward individuals such as Karic have been credited with playing a significant role in getting the parties to agree to the Dayton Accord (Cortright and Lopez 2000, 63).

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If targeted financial sanctions cannot directly force leaders and their associates to change their behavior, they can at least penalize them for it and reveal their ill-gotten gains to the general population. Financial sanctions are also useful as a way of indicating the international community's displeasure and as a warning to other leaders who are tempted to contravene international norms of civil conduct.

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5 "Tycoon brothers join cast in diplomatic effort," *National Post*, May 6, 1999, p. A12.

Enforcing Targeted Financial Sanctions

Financial sanctions are not easy to enforce, since the international financial structure operates largely outside state control. Structures and systems can, however, be put in place to facilitate the implementation and enforcement of sanctions.

The most sophisticated system now in place to administer financial sanctions is that used by OFAC. This US government agency sets out penalties for failure to abide by sanctions and allows responsible financial institutions and individuals to determine how best to comply. OFAC undertakes very little enforcement or compliance monitoring, but it does attempt to ensure that all financial institutions and other groups affected and obligated by US sanctions are aware of the individuals and companies that are on US sanctions lists.

When targeted individuals and entities use the elaborate techniques employed by criminal money launderers and tax evaders, the financial sanctions challenge becomes even greater.

When targeted individuals and entities use the elaborate techniques employed by criminal money launderers and tax evaders, the financial sanctions challenge becomes even greater. Few targeted despots stumble late in life on the fact that the rest of the world disapproves of their acts and wishes them ill. Rather, most start hiding their assets early in their careers. Though daunting, however, the challenge is made less difficult by the fact that, while a seemingly inexhaustible supply of garden-variety felons is engaged in money laundering and the like, the number of rogue political leaders against whom financial sanctions would be applied is so much smaller that it should be relatively much easier for the international community to marshal the resources necessary to combat them.

For an analogy, one can look to the UN operation against Iraq's attempts to develop weapons of mass destruction. The massive UN effort enjoyed support from intelligence services around the world, which provided vital information through signals intelligence (communications interception) and other assistance. Such resources directed toward the task of discovering hidden assets and financial covers would be a necessary and invaluable part of any thorough effort to ensure the success of financial sanctions.

Drawing on existing multilateral and unilateral sanctions experience, it should be possible to develop an enforcement and intelligence structure for financial sanctions. The developed world's intelligence and enforcement agencies would then be able to establish link charts and prepare to move quickly if the call comes and if they can be persuaded to take time off from pursuing their own national-security-related agendas. They could also liaise with private sector financial institutions and other commercial entities. In many ways, the work of such a structure would be analogous to that done by the United States' Financial Crimes Enforcement Network (FINCEN), which provides analytical research services to US enforcement authorities by searching databases and other sources for evidence of relationships between targets and other persons or entities. FINCEN also analyzes, interprets the results of, and provides organizational charts based on the results of its research. One difficulty with involving intelligence agencies in this sort of

exercise is they are often busy pursuing their own agendas, but in most cases they would be coincident with the multilateral group enforcing the sanctions.

Backing up the sophisticated monitoring and analysis capabilities of the developed world's intelligence agencies[6] would be good old-fashioned human intelligence, which can often turn out to be the best source of the information that uncovers the assets or disguised financial flows of targeted individuals or groups. Most tyrants are naturally wary of those around them and tend to trust only a relative or other close associate to keep an eye on their hidden assets. Such reliance on a trusted insider can backfire, however, if the insider is targeted for surveillance. For example, the assets of an African country's leadership were discovered after a source hostile to the regime notified Canadian financial authorities that one of the leaders' wives was visiting Canada to engage in financial transactions.[7]

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It is possible that a financial sanctions program could successfully get under way even without the creation of a special investigative and intelligence capacity. As occasionally happens now, private sector forensic accounting and investigative firms could be employed to locate assets and then hand the information over to the relevant legal authorities for further action. In one such instance, a private sector financial investigative firm was retained to search for assets belonging to Ferdinand Marcos, "Baby Doc" Duvalier, and Saddam Hussein, among others. Working for the Kuwait Investment Office in London, the firm, in a thorough investigation of public records and assisted by the creation of large text databases capable of sorting names, bank accounts, and other data points, located tens of millions of dollars of assets connected to Saddam Hussein and attached to a front corporation in Switzerland.

Integrating valuable (and secretive) government intelligence resources, such as signals intelligence, into the process would be difficult, but a hybrid approach might work that allocated specific roles to public and private sector actors in the financial sanctions process. At a minimum, however, the market mechanisms and the pursuit of personal gain that afford rogue leaders the opportunity to evade sanctions can also be used against them. For example, bounties and rewards could be offered for information on front companies, pseudonyms, numbered accounts, and other hidden assets connected to the targeted leadership group that would not only pay real dividends but also

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6 As an example of the kind of work such bodies can undertake, in 1997 the British signals intelligence agency apparently intercepted a wire transfer of US$800,000 from Iraqi deputy prime minister Tariq Aziz to an account irrefutably linked to then Russian prime minister Yevgeny Primakov. While working as a *Pravda* correspondent in the Middle East, Primakov reportedly became friendly with Saddam Hussein and has since been accused of working to assist Iraq's weapons program, an accusation Russia vehemently denies. Intelligence services say they routinely "vacuum" up information such as the Aziz wire transfer of funds.

7 Discussions with Canadian banking officials. Control over one's own banking system can be quite an asset for those who engage in clandestine finance. In one notorious case, the Ivy-League-educated former vice-president of a middle-European quasi-central bank ended up in Cyprus ably quarterbacking her country's sanctions-busting efforts. There are, however, limits. A rogue leadership's control over its country's internal banking system merits strict controls on dealings with banks from such countries, particularly as the leaders inevitably will try to move financial assets out of the country as a hedge against their possible overthrow.

create an atmosphere of suspicion among members of the inner circle that would bring further pressure to bear.

The Need to Go Beyond Monitoring to Enforcement

Simple discovery of rogue leaders' assets or clandestine financial activities would not, however, be enough. In the early 1990s, for example, the United Nations, in conjunction with the European Union, the United States, and Canada, set up an elaborate system to monitor the implementation of the increasingly severe economic sanctions imposed on Yugoslavia. Yet the system lacked an efficient enforcement capacity, so that widespread sanctions busting permitted a steady stream of goods and supplies to flow into the hands of Milosevic and his associates even as the general population suffered considerably.[8]

Any decision to impose targeted financial sanctions must be backed up by the resolve to enforce controls, disrupt clandestine financial activity, and freeze assets.

Thus, any decision to impose targeted financial sanctions must be backed up by the resolve to enforce controls, disrupt clandestine financial activity, and freeze assets. The absence of the multilateral capacity and political will to do so would greatly diminish the impact of sanctions. It would be particularly important to deny those targeted by sanctions the use of financial havens. Indeed, it is possible that countries that are now reluctant to participate in programs to combat money laundering and clandestine financial dealings might well be convinced to cooperate with an international effort against the occasional targeted despot as long as their usual clientele were not unduly disturbed.

Conclusion

Recent criticisms of sanctions efforts as inefficient, imprecise, unnecessarily destructive, and only partially effective are largely accurate. But these are criticisms of general trade sanctions or of targeted sanctions that have been improperly or carelessly implemented. No serious attempt has yet been made to implement and enforce targeted financial sanctions of the type I have described in this *Backgrounder*. Well-implemented, well-enforced targeted financial sanctions can play a valuable role in punishing or changing the behavior of offending authoritarian leaders. More work needs to be done, however, to establish the appropriate structures and systems necessary for an efficient mechanism acceptable to the international community, and Canada can make a valuable contribution to this process. At a minimum, financial sanctions should be used as an alternative to or necessary precursor of military intervention, with its dramatically higher financial and human costs.

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8 The US Department of State reported in 1995 that this monitoring effort involved approximately 220 customs monitors, 50 of whom were American (United States 1995).

Appendix: A Proposed Strategy for Investigative and Analytical Approaches to Financial Sanctions

- Receive initial information indicating that certain political leaders and their associates are candidates for targeted financial sanctions. Develop a flow chart of all possible relationships, including biological and business relations. Look for weaknesses in the interrelationships
- Develop relationships with informants and witnesses who possess details of the leadership's financial operations. Deal with a lower member of the leadership and its associates who might decide to assist the investigation. Contact rivals or former spouses of the leaders and their associates who might be cooperative and have valuable information. Identify individuals and entities that might be holding assets on behalf of the leaders or their associates.
- Compile information on indications of wealth exhibited by the leadership and suspected assets. Perform a "net worth" calculation on the leaders and their associates.
- Consider an undercover operation to gather more information. It could be useful to disrupt the activities of the leaders and their associates to make them more susceptible to such an undercover operation.
- Use signals interception technology to monitor the communications of the leaders and their associates. Engage in traffic analysis of frequently called or foreign numbers.
- Explore other avenues of investigation, such as telephone or communications records that reflect contacts with banks or other financial services and records of real estate transactions or other major purchases that might reveal methods and sources of payments.
- Identify financial havens in which a target might be hiding assets.
- Seize known assets of the leadership and its associates. Add the names of these people into an interdict database, thus effectively cutting them off from legitimate commerce and finance.
- Continue surveillance of leaders and their associates with a view to discovering the identities of additional banks or financial institutions associated with them (as their financial resources are squeezed, leaders and their associates might begin to switch to new or heretofore dormant financial institutions, thus increasing opportunities for disclosure).

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